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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 440

BENJAMIN F. LINDHEIMER AND OTHERS, CONSTITUTING THE ILLINOIS COMMERCE COMMISSION OF THE STATE OF ILLINOIS; OTTO KERNER, ATTORNEY GENERAL OF THE STATE OF ILLINOIS, AND THE CITY OF CHICAGO, APPELLANTS,

vs.

ILLINOIS BELL TELEPHONE COMPANY.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF ILLINOIS.

STATEMENT SHOWING BASIS OF JURISDICTION AS REQUIRED BY RULE 12.

In compliance with Rule 12 of this Court, appellants state:

(*a*)

The basis of this Court's jurisdiction is that this case was heard by the Federal statutory court of three judges sitting in the District Court, Northern District of Illinois, Eastern Division, under the provisions of Section 266 of the Judicial Code as amended (Sec. 380, Title 28, U. S. Code annotated), which provides for a direct appeal to the Supreme Court from a final decree granting or denying a permanent injunction of a suit of the character of this one.

(*b*)

The decree herein sought to be reviewed was entered by said court on June 28, 1933, and the application for the appeal to this Court was presented to said court on June 28, 1933, and the order allowing appeal was entered June 28, 1933.

(*c*)

The Illinois Bell Telephone Company filed its bill of complaint in said district court to restrain the Illinois Commerce Commission, a body duly created by the statutes of the State of Illinois, and the Attorney General of said State from enforcing against the plaintiff certain rates for telephone service fixed for the city of Chicago by said Commission, through its order of August 16, 1923. The bill alleged that the rates so fixed did not afford a fair return upon the fair value, at the time of use, of its property, used and useful in and exclusively devoted to intrastate telephone service in the said city of Chicago, but that said rates were confiscatory, unfair and unreasonable, and contrary to law and void, and in violation of the plaintiff's rights under the 14th Amendment of the Constitution of the United States.

The city of Chicago was given leave to intervene by an order entered September 27, 1923, and an interlocutory decree was entered December 21, 1923, from which an appeal was taken to this Court, and said interlocutory decree was affirmed October 19, 1925 (*Smith et al.* v. *Illinois Bell Telephone Company,* 269 U. S. 531). A final decree was entered on February 28, 1930, from which an appeal was taken to this Court and said final decree was reversed (*Smith et al.* v. *Illinois Bell Telephone Company,* 282 U. S. 133). Additional evidence was heard, pursuant to the mandate of this Court, following which the final decree herein sought to be reviewed was entered on June 28, 1933.

The final decree entered June 28, 1933, held that the telephone rates prescribed for the city of Chicago by said Illinois Commerce Commission's order of August 16, 1923, were confiscatory and deprived plaintiff of its property without due process of law and denied plaintiff equal protection of the law under the Federal Constitution.

(*d*)

The jurisdiction of this Court is sustained by the said statutory provision granting direct appeal from the order of the district court in such case (Section 266 of the Judicial Code, Title 28, Sec. 380 U. S. Code).

Interstate Busses Corporation v. *Blodgett*, 276 U. S. 245.

BENJAMIN F. LINDHEIMER,
ERNEST J. KRUETGEN,
ANDREW OLSON,
G. GALE GILBERT,
PHIL. W. COLLINS,
PAUL SAMUELL,
CHARLES E. BYRNE,
Constituting the Illinois Commerce Commission.
OTTO KERNER,
Attorney General of the State of Illinois.
CITY OF CHICAGO,
Appellants,
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Corporation Counsel.
BENJAMIN F. GOLDSTEIN,
GEORGE I. HAIGHT,
EDMUND D. ADCOCK,
Special Attorney.

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vs.

ILLINOIS BELL TELEPHONE COMPANY.

MOTION BY APPELLANTS TO ADVANCE CASE.

And now come all of said appellants, by their solicitors, and move that a hearing of the said cause be advanced to January 15, 1934, or to an early date thereafter. By agreement, appellants' brief is to be printed and delivered to appellee on November 22, 1933, and appellee's brief is to be printed and delivered to appellants on January 3, 1934. On the basis of that agreement, appellee has no objection to this motion to advance the hearing of this cause.

A Statement of the Matters Involved.

Appellants appeal from the final decree entered on June 28, 1933, by the District Court of the United States for the Northern District of Illinois, Eastern Division, pursuant

to Section 266 of the Judicial Code, enjoining them from enforcing on grounds of confiscation the rates for telephone service in the city of Chicago prescribed by the final order of the Illinois Commerce Commission made August 16, 1923, and directing that appellee retain the amounts collected by it during the period of the litigation in excess of the sums chargeable under the said order, which amounts now aggregate in excess of $17,000,000, exclusive of interest.

The final decree herein, incorporating by reference the district court's opinion of April 29, 1933, was entered as a result of hearings held pursuant to the opinion and decree of this Court given on December 1, 1930, in the case of *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133, which reversed the final decree of the district court theretofore entered on February 28, 1930, and remanded the cause for further hearings in conformity therewith.

The final decree of June 28, 1933, embraces certain findings, which we summarize and explain as follows:

1. *Fair Return.*

The district court found that, to avoid confiscation, the fair return on the rate base as found by it was 7½ per cent for each of the years 1923 to 1927 inclusive, 7 per cent for the years 1928 to 1930 inclusive, 6½ per cent for 1931, and 5½ per cent for 1932. The record shows that such rate of return would enable appellee to pay interest and amortization on money borrowed and would yield to appellee's stockholders on their investment allocable to appellee's Chicago intrastate business a rate of return on capital stock ranging from 10.94 per cent in 1931 to 21.04 per cent in 1925, and a rate of return on capital and surplus ranging from 9.47 per cent in 1931 to 18.95 per cent in 1923. Such rate of return was exclusive of and in addition to the ad-

vantages of pecuniary profit to the investors of appellee, specified below, allowed by the district court, and not received by ordinary investors in other business undertakings outside the Bell System. The record shows that the recorded net income from the existing rates under which appellee had functioned during the period of the litigation and on the basis of which it had doubled its capital investment, would yield a return of from 4.37 per cent to 5.86 per cent on the rate base as found by the district court. From such recorded income appellee was able to pay an 8 per cent cash dividend each year during the litigation on such outstanding capitalization, and to carry $8,950,000 to surplus. The record also shows that the reduction in recorded net income which would have resulted had the rates in suit been in force, ranged from $454,000 to $614,000 during the years 1923 to 1927 inclusive, $1,200,000 in 1928 and 1929, $892,000 in 1930, and $228,000 in 1931, and for the entire period aggregated $6,420,000.

The district court applied to appellee that part of the standard of the Bluefield case covering the required minimum return by comparison with the return generally received by investors in other business undertakings on the basis that appellee was an ordinary public utility bearing the ordinary relationship to its investors. Such application failed to give effect to the fact that appellee was part of a system which functioned under a mutual plan of operation, under which appellee burdened its operations for the benefit of the American Telephone & Telegraph Company as consideration for the reciprocal benefits from that company as its investor and as its financing agency. The district court gave effect to the burdens on appellee in its findings on separation of revenues, license contract service and payments, Western Electric Company, maintenance, and value of property in service for rate making

purposes, but failed to give effect to the reciprocal benefits to be received from the American Telephone & Telegraph Company in its findings on fair return.

The district court's findings on fair return failed to give effect to appellee's actual experience during the period under investigation under the recorded income from the existing rates, and to the comparable actual experience of the Associated Companies of the Bell System, and failed to make any application of that part of the standard of the Bluefield case covering the required minimum return to attract capital and to maintain the stability of the securities of the complaining utility.

2. *Separation of Revenues.*

The district court, without discussion, followed appellee's allocation for each year under investigation to interstate toll business of substantial portions of gross and net revenues arising under the existing rates—ranging from $350,000 to $650,000, and from $260,000 to $500,000 respectively, and of substantial portions of net revenues arising under the rates in suit—ranging from $254,000 to $485,000 respectively. Similar allocation was made of portions of the Chicago intrastate exchange service revenues under the existing rates to the intrastate toll business—ranging from $650,000 to $1,300,000, and from $450,000 to $1,050,000 respectively. The above separation was made on the basis of an alleged universal understanding that the Chicago exchange service rates compensate appellee for every interstate and intrastate toll use of the Chicago exchange plant facilities by the subscribers to the toll services who may or may not be subscribers to the Chicago exchange service, or to any of the services of appellee. The record shows that such alleged understanding was not expressed in any filed rate schedules covering the Chicago

exchange service rates, was not contained in any document filed in connection therewith, and disregarded appellee's fifty years' history of Chicago exchange service rate making and appellee's fifty years' history of its contractual relations with the operators of the toll services.

3. *License Contract Service and Payments.*

The district court, on the basis of appellee's presentation, included in appellee's license contract costs allocable to its operating expenses each year under investigation amounts ranging from $590,000 to $790,000, which included:

(*a*) A portion of the American Telephone & Telegraph Company's expenses applicable to it as a holding company investor of the securities of appellee covering the cost of raising capital to make the investment, of servicing the outstanding securities issued to raise such capital, and of operating 10 departments whose operations are concerned in whole or in part with its functions as such holding company investor;

(*b*) a portion of the American Telephone & Telegraph Company's Development and Research expense to develop inventions applicable to the non-telephone communication field, to the telephone communication field outside the field covered by Western Electric sales to its retail customers, and to the American Telephone & Telegraph Company as the operator of the long-distance service, as the holding company investor in the securities of appellee, and as the licensor, for valuable consideration, of the Western Electric Company to manufacture and sell to appellee products embodying the results of the development and research work covered by such expenses;

(*c*) a portion of the $30,395,800 transferred from 1923 to 1927 inclusive by the American Telephone & Telegraph Company to its reserve for contingencies.

4. *Depreciation Expense.*

The district court found depreciation expense charges properly chargeable as operating expenses under the existing rates and under the rates in suit during each year under investigation, which exceeded the charges prescribed by the Commission's Order of December 20, 1920, establishing the telephone rates in force during the litigation, and by the Commission's Order of August 16, 1923, establishing the telephone rates attacked herein. Such allowed annual charges were from $1,100,000 to $1,500,000 more than those prescribed by the 1920 order, and from $1,200,000 to $3,400,000 more than those prescribed by the 1923 order.

The district court gave no effect to the facts that (*a*) the commission's order on depreciation in each case was made pursuant to the statutory provision in effect in Illinois, (which statutory provision exists in fifteen other States), obligating the utility to conform its depreciation charges to the amount fixed by the commission in the exercise of its power granted under such statute; (*b*) no attack has ever been made on the 1920 order and no ground exists to hold void that portion thereof covering depreciation; and (*c*) when attacked, the 1923 order on depreciation must be treated with the respect to be attached to a legislative act. The district court made no finding that either the 1920 order or the 1923 order on depreciation was void, but made findings which gave effect to appellee's showing on depreciation expense which showing (*a*) included substantial annual contributions computed on the straight line method for anticipated depreciation on future additions to buildings and central office equipment contemplated to be acquired, and to be placed in service from time to time in 1974, and (*b*) gave effect to its reproduction cost estimate for each year.

5. *Western Electric Company.*

The district court, on the basis of appellee's presentation, found—(*a*) the costs, profits and investment allocable to Bell business separated from that allocable to non-Bell business; (*b*) the relationship between such costs, profits and investment so determined for Bell business and that for business with appellee; and (*c*) the reasonableness of the profits from business with appellee so determined—in each case on the basis of the permanent continuous relationship of the Western Electric Company and the Bell System throughout the period of the litigation and prior thereto to 1916, considered as a single unit of time. The district court did not determine the Western Electric profits from Bell business and from appellee and the reasonableness thereof in the light of the different uses made of the Western Electric prices in connection with the estimates upon which the charge of confiscation was predicated for each year of the litigation, as found by the Court. The record shows that such uses cover (*a*) the substantial purchases made each year attributable to maintenance and other expense charges; (*b*) the purchases over a period of years reflected by the book cost of plant of each year; and (*c*) the assumed purchases which would be made during the group of years of the assumed construction period for appellee's reproduction estimate of the plant in service each year on the basis of the Western Electric prices of the year of revaluation.

On the basis of the district court's finding of Western Electric profits from Bell business and from business with appellee for each of the years 1923 to 1931 inclusive, the rate of return to Western Electric therefrom for each such years viewed as a separate unit of time is grossly excessive.

6. *Maintenance.*

The district court found as a proper expense charge for each year of the litigation the amount of maintenance charges shown by appellee, which maintenance charges covered substantial purchases from the Western Electric Company ranging from $1,446,000 to $4,520,000 per year during the years when the Western Electric Company profits from its business with appellee as found by the district court were grossly excessive.

7. *Value of Property for Rate Making Purposes.*

The district court found the fair value of the Chicago intrastate property in service for each of the years under investigation based upon the reproduction cost estimate of appellee. Such fair value was from 40 per cent to 80 per cent more than appellee's capitalization, including surplus, allocable to such business in each year. Such findings of fair value (*a*) gave effect to appellee's reproduction cost new estimates of the physical property, based upon the application of index numbers and of the Western Electric prices of the year of revaluation, (*b*) were not based on appraisals of the property other than land and buildings, and (*c*) gave effect to appellee's showing of undistributed construction costs (overheads) which were from three to five times the amount of overheads shown by appellee's experience during the period under investigation, when its plant account increased over 85 per cent.

The district court's finding on undepreciated value new of the property in service gave effect to the reproduction cost new estimates for each year under investigation, except that for the years 1930, 1931 and 1932 it reduced the same by 10 per cent to eliminate the effect of the 10 per cent increase in Western Electric prices in 1930.

The district court's finding of rate base (*a*) included for going value amounts which were more than twice the amounts prescribed by the Illinois Commerce Commission's order of August 16, 1923, and represented from 13 per cent to 16 per cent of the capitalization allocable to the Chicago intrastate service, including over $50,000,000 of capital invested during the period of the litigation on the basis of purchasing appellee's securities at or below par, and (*b*) deducted for depreciation in valuation 16 per cent of the reproduction cost new estimates for the years 1923 to 1928, inclusive, and 15 per cent for the succeeding years, which deductions were from $4,700,000 to $17,300,000 less than the amounts in the depreciation reserve account as of the same dates, on the basis of the district court's findings on depreciation expense.

Reasons for the Application for Advancement.

1. This is a case once adjudicated by this Court upon the merits, and again brought up (Paragraph 5 of Rule 20 of the Rules of Practice of the United States Supreme Court).

2. The pendency of this case has prevented, since 1923, and now prevents, any further investigation into the rates, revenues, and expenses of appellee, as many of the questions which must arise in such investigation are awaiting final disposition of this case.

3. Many issues arising from the relationships between appellee and the American Telephone & Telegraph Company covering revenues, expenses and rate of return awaiting final disposition in this case are also present in every investigation before the Illinois Commerce Commission relating to the proper rates to be charged by appellee in the many communities in the State of Illinois.

4. Disposition of this case should dispose of and settle the controversy as to the proper rules covering the account-

ing between the holding company and its subsidiary operating utilities, the weight to be given to reproduction cost new of property, the propriety of deducting from the valuations of property, for rate making purposes, the amount included in the reserve for depreciation, and the jurisdiction of State commissions over the method of determining the amount of depreciation expenses of telephone companies, and the proper application of the standard of the Bluefield case to the mutual plan of operation, under which the twenty-four Bell Telephone Operating Companies functioned.

5. The difficulty of identifying the subscribers to whom refund must be made, should the final decree be reversed by this Court, is so increasing with time as to tend to render such reversal ineffective as to charges already made.

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